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C O N F I D E N T I A L SECTION 01 OF 04 TEGUCIGALPA 001970

SIPDIS

STATE FOR WHA/CEN, WHA/EPSC, DRL/IL, AND EB/ESC
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E.O. 12958: DECL: 09/22/2015
TAGS: EPET ECON ELAB PGOV KSAC HO
SUBJECT: HONDURAN FUEL SECTOR CONCERNED ABOUT GOH GASOLINE
PRICE FREEZE AND OTHER PROPOSED RESTRICTIONS

REF: A. A) TEGUCIGALPA 1851

¶B. B) TEGUCIGALPA 1873
¶C. C) TEGUCIGALPA 1910
¶D. D) TEGUCIGALPA 1958

Classified By: ECONCHIEF PDUNN FOR REASONS 1.5(B AND D)

¶1. (C) Summary. Gasoline prices in Honduras remain in limbo, as a de facto price freeze appears to remain in effect, but with no GOH decree mandating such a policy. Some in Congress have suggested price caps should remain in place until December 31, with importers being forced to pick up the tab, since they are perceived to be the ones profiting most from the current spike in gasoline prices. This is a red-herring, as importers have the smallest profit margins of any participant in the value-chain. However, no political will exists to take on the politically powerful transport companies or gas station operators to reduce their excessive guaranteed margins. The industry might have little choice but to go along with a plan presented by President Maduro that would subsidize fuel purchases by taxis and buses. The precise mechanism for implementing such a plan remains undefined. Political theater aside, little has been done to establish a viable long-term fuel pricing strategy, and industry is concerned that changing the rules of the game unilaterally and without warning could hamper investment or even cause fuel shortages. Post believes that the long-term solution must be a move away from government price controls and toward increased competition and improved consumer protection through rigorous anti-trust enforcement. End Summary.

¶2. (C) Gasoline prices in Honduras remain in limbo, as a de facto price freeze appears to remain in effect, but with no GOH decree mandating such a policy. As reported refs A-C, the GOH rolled back fuel prices on September 7 to pre-Hurricane Katrina prices and froze those prices for a period of ten days. The cost differential was to be reimbursed by the GOH directly to gasoline retailers. In the meantime, a Commission of Notables was established to review and revise the fuel pricing formula, and given ten days to report their results. The Commission report did not succeed in revising the fuel pricing formula, and went well beyond the Commission mandate -- by suggesting reviews of electricity contracts, state intervention in fuel imports, and other policies -- prompting a number of Commission members to resign (ref D.) Since the expiry of the initial ten day freeze, the price freeze has remained in effect, but without benefit of a Congressional decree. Thus, there is no formal justification for the freeze and, more worrisome, no determination of who will pay for it.

¶3. (C) Members of the National Congress have suggested over the last several days that "fuel importers" should be forced to absorb any losses incurred by the price freeze, and some have gone so far as to suggest the freeze should be extended through December 31, 2005. Both politicians and the media have loudly accused the "transnational companies" of profiteering, and mistakenly feel these companies have more than ample margins to absorb this additional cost. The fundamental misinformation in this debate was graphically demonstrated in a September 22 article in the newspaper El Heraldo, which explained the profit margins of each stage of the fuel delivery and marketing chain. Despite the accompanying pie-chart that clearly showed that importing firms have the smallest profit margins by far, the headline read: "Importers gain the most."

¶4. (C) Seeking a politically viable exit strategy, President Ricardo Maduro called petroleum sector representatives to his office the evening of September 20. According to Texaco Country Manager Luis Mayorga, who was present at the meeting, Maduro proposed that the gasoline retailers agree to freeze prices for taxis and buses only, while selling to the public at market prices. Maduro said the plan would remain in effect until December 31, or until total costs had reached 70

million lempiras (approximately USD 3.7 million). In exchange, Maduro said, the GOH would reimburse gasoline retailers for losses stemming from the second 10-day period (from September 17 to 26) of price freezes. Mayorga told EconChief that this plan would cost his company an estimated USD 750,000.

¶5. (C) Petroleum sector representative responded that they would examine the request, and expressed concerns that if they yielded in Honduras, other countries would seek similar sacrifices. They encouraged Maduro to think long-term and to guarantee predictability of investment rules. They also said they are concerned about maintaining a level playing field and about changing the rules governing investments in mid-course. The ultimate consequences of such behavior, they warned, could be a drop in investment in Honduras (for example, no new or expanded gas stations or distribution infrastructure) or even a fuel shortage. In what could be viewed as a shot across the bow of industry, the Commission of Notables has reminded importers that if they choose not to cooperate, the state could import directly and use private industry storage to supply the domestic market.

¶6. (C) Industry has also told the GOH that if they are to go along with the President's proposal, they require a formal decree to be issued outlining the specifics of the plan, the duration, the cost, and the terms under which those costs will be absorbed by each party. Under U.S. anti-trust law, colluding on prices, subsidizing foreign governments, or offering differential pricing to distinct segments of the public are illegal. The companies could not contemplate cooperating in the new scheme unless ordered to do so by the GOH, and even then they will need to refer the matter to their lawyers. Moreover, industry has also suggested that a tiered price regime at the pump level (one set of prices for taxis, another for consumers) would be an administrative nightmare. (In an interesting bit of frankness, President of the National Transport Union Jorge Lopez told reporters that he feared such a scheme would encourage taxi drivers to stop hauling passengers and instead get into the gasoline resale business.) To minimize fraud, the GOH contemplated limiting taxis to six gallons per day at the controlled price. Far easier and less subject to abuse, the petroleum industry is promoting a system administered by the Ministry of Transportation (SOPTRAVI) that simply would reimburse all registered taxi drivers the equivalent of the price differential for six gallons per day. A database of registered taxi and bus drivers already exists and could be used for this purpose. (Comment: Post was thinking along similar lines, and notes another potential benefit: unlicensed taxis would not benefit from the subsidy, assisting the GOH in its apparent crackdown on these operators. Other recent actions by the GOH Council of Ministers seem similarly targeted at taking advantage of the current crisis to impose some order on the taxi and bus sector, and in particular to weed-out unlicensed operators currently clogging Tegucigalpa traffic (ref D). End Comment.) Minister of Trade and Industry Irving Guerrero told EconChief on September 23 that such an arrangement is already under study, with SOPTRAVI coordinating with the Ministry of Finance to identify beneficiaries and establish modalities.

¶7. (C) Regarding the current formula by which the GOH manages fuel prices, Mayorga said the formula works sufficiently well when prices are below USD 50 per barrel. As prices have climbed, however, the formula has become increasingly unpopular. IMF ResRep Hunter Monroe separately told EconChief that the underlying problem is two-fold: First, the lack of competition in the sector in Honduras has led to very high pre-tax prices for fuel (which is then exacerbated by some of the highest fuel taxes in the region.) Second, he said, the GOH formula reacted too quickly to price swings in the market, mimicking the upside volatility of the price increase, but not adjusting down quickly enough. Mayorga echoed this sentiment, noting that in El Salvador (which has a freely competitive gasoline market), prices only increased by seven cents, versus the nearly one dollar swing seen in Honduras. In large part, Mayorga said, this reflects industry understanding that price volatility (especially panic buying due to storms and other sudden exogenous shocks) is both natural and temporary, and that retail prices should not spike every time the market does. By waiting a day or two for the markets to settle, retailers in El Salvador reportedly were able to raise prices appropriately, but not so sharply as in Honduras, thereby avoiding the public outcry and civil unrest that accompanied that price shock.

¶8. (C) The current pricing formula establishes profit margins for each link in the fuels value chain, from importation through retail sales. On a gallon of gasoline, for example, profits are as follows:

GOH	USD 1.15
Transport	USD .85
Retailer	USD .25

Wholesaler	USD	.11
Importer	USD	.04

Two facts are readily apparent from the above. First, importers -- easy political targets because they are often foreign multinationals -- make the least of any of the participants in the process. (Mayorga told EconChief that four cents per gallon is a good profit, but not excessive, and certainly not the biggest profit margin in the value chain.) Second, aside from GOH tax revenues, the largest profits are made by the transport companies. According to Monroe, Article 18 of the Honduran Transportation Law requires that only natural-born Honduran citizens can own transport trucks, and joint venture trucking companies must be majority Honduran-owned as well. This lack of competition has led, predictably, to price gouging. (Privately, the Minister of Industry referred to the trucking companies as "pirates.")

¶9. (C) Nor do the foreign firms make windfall profits as retailers. Of the approximately 450 gasoline stations in Honduras, for example, 98 are Texaco. Of those 98, only 13 are owned and operated by the company, while 27 are company-owned and dealer operated, and 58 are dealer owned and operated. The operators receive the 25 cent per galllon profits, not Texaco. Esso has a similar ownership mix (owning and operating only 14 out of 68 stations), while both DIPPSA (a Honduran company) and Shell (the other two major brands in the Honduran market) gasoline stations are all company owned but dealer operated. Mayorga also pointed out that a 25 cent per gallon margin for operators is extremely generous -- the industry average in the region is 12 to 15 cents per gallon. According to Mayorga, while this is the obvious place to cut prices in the formula, the GOH fears offending the politically powerful elites that operate these stations (including Juan Ferrera, one of the members of the Notables Commission). ADHIPPE, the Honduran association that represents gasoline station owners, meanwhile has gone on the offensive, accusing multinational companies of unfair competition, loudly proclaiming that (even with their grossly bloated profit margins) their members are barely making a living, and threatening to march on Tegucigalpa if the GOH seeks to adjust those profit margins downward.

¶9. (C) Comment: It is disappointing but perhaps not surprising that the Commission of Notables has failed to address the core concern of fuel prices. With no technical expertise in the sector, the Commission was unlikely to arrive at such a solution, particularly in just ten days. Even so, the squabbling and politicization of the issue has done little to ameliorate the situation. By not taking action on many of the Commission's suggestions and instead interacting with the petroleum sector directly, the GOH Council of Ministers seems implicitly to recognize that the Commission has not lived up to expectations. The industry, fearing an even worse alternative to the present price controls, is willing to go along in the short-term, but sees a clear need for a long-term approach that is predictable and guaranteed. Post believes the long term strategy must include increased competition and improved consumer protection. With a newly passed anti-trust law on the books, the GOH is on its way to developing the regulatory capacity to crack down on monopolistic pricing. Opening the gasoline market to competition should drive prices and margins down to levels commensurate with the rest of the region, and any attempts to exert market power (whether by transnationals or domestic firms) should be met with strong penalties. That said, the GOH is far from having the technical capacity to undertake such enforcement, and it is our view that the political will for such a bold move -- on the eve of a Presidential election -- is simply not there. We will continue to watch as events develop, encouraging a short-term policy that protects both investors and consumers, and a long-term move towards free competition. End Comment.

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